Towards de-financialisation

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Structure of presentation

- The present era of financialisation
- The economic impacts of financialisation
- Some modest proposals for re-structuring financial sector

Financialisation

- ‘financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies’ (Epstein, 2005).

Financialisation

- Financialisation in the Epstein sense has been long occurring. Verchelli, for example, identifies first era of financialisation (1860s to 1929) and a second era (since circa 1980).

Features of financialisation

- No single agreed conceptualisation of financialisation, and what has been involved since say circa 1980.
- For purpose here financialisation would include the large –scale expansion and proliferation of financial markets over the past thirty years, interwoven with de-regulation and liberalisation, proliferation of securitisation and derivatives, credit expansion particularly to households.

Features of financialisation

- Other writers have focused on interrelationships between growth of the financial sector and inequality; others on ‘pursuit of stakeholder value’.

- ‘Financial development’ (e.g. size of banking system, stock market) and economic growth have generally been viewed, theoretically and empirically, as positively related; the debates have been on the direction of causation.

- The financial development and liberalisation literature generally took a favourable view of the growth of the financial system:
- ‘A growing body of empirical analyses, including firm-level studies, industry-level studies, individual country-studies, time-series studies, panel-investigations, and broad cross-country comparisons, **demonstrate a strong positive link between the functioning of the financial system and long-run economic growth**.

What have been the effects of financialisation?

- …the preponderance of evidence suggests that both financial intermediaries and markets matter for growth even when controlling for potential simultaneity bias. Furthermore, microeconomic-based evidence is consistent with the view that better developed financial systems ease external financing constraints facing firms…. **Theory and empirical evidence make it difficult to conclude that the financial system merely—and automatically—responds to economic activity, or that financial development is an inconsequential addendum to the process of economic growth**.' (Levine, 2005, p. 921; emphasis added)

What have been the effects of financialisation?

- Students of financialisation have taken a much broader perspective on the effects of the growth of the financial sector and a less optimistic one.

Financial development

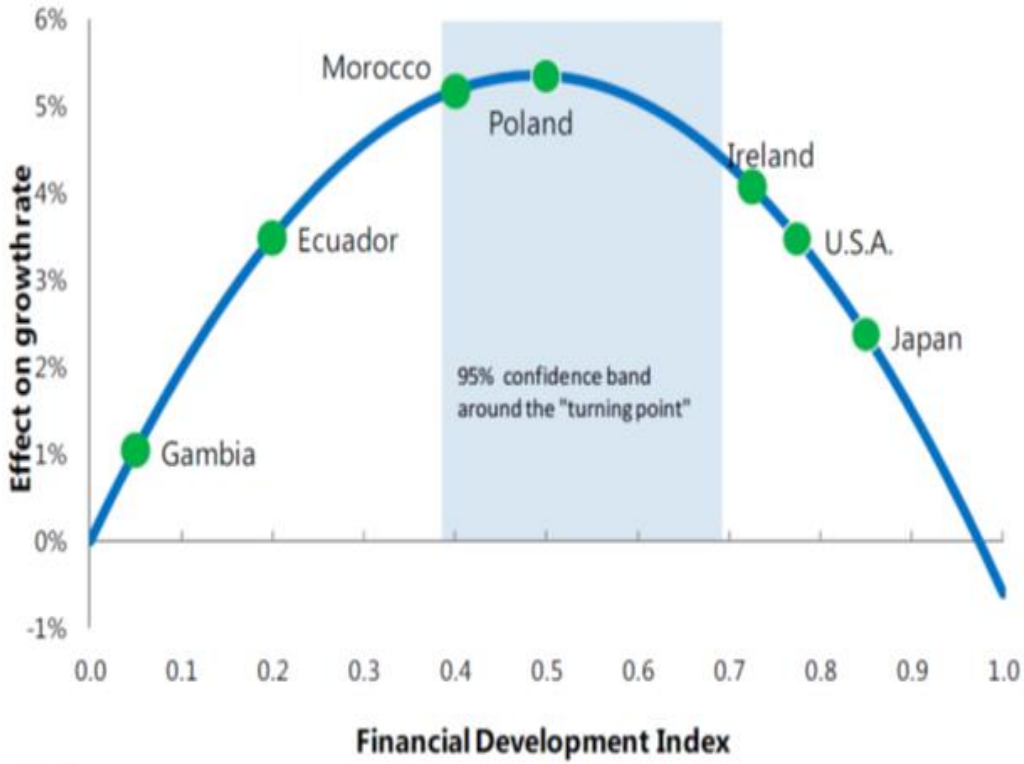
- The financial development– economic growth nexus – has it changed?
- Bank of International Settlements studied 'the complex real effects of financial development and come to two important conclusions. First, financial sector size has an inverted U-shaped effect on productivity growth. That is, there comes a point where further enlargement of the financial system can reduce real growth. Second, financial sector growth is found to be a drag on productivity growth.

Financial development

- Two other illustrative findings

What have been the effects of financialisation?

Figure 7. Financial Development Effect on Growth

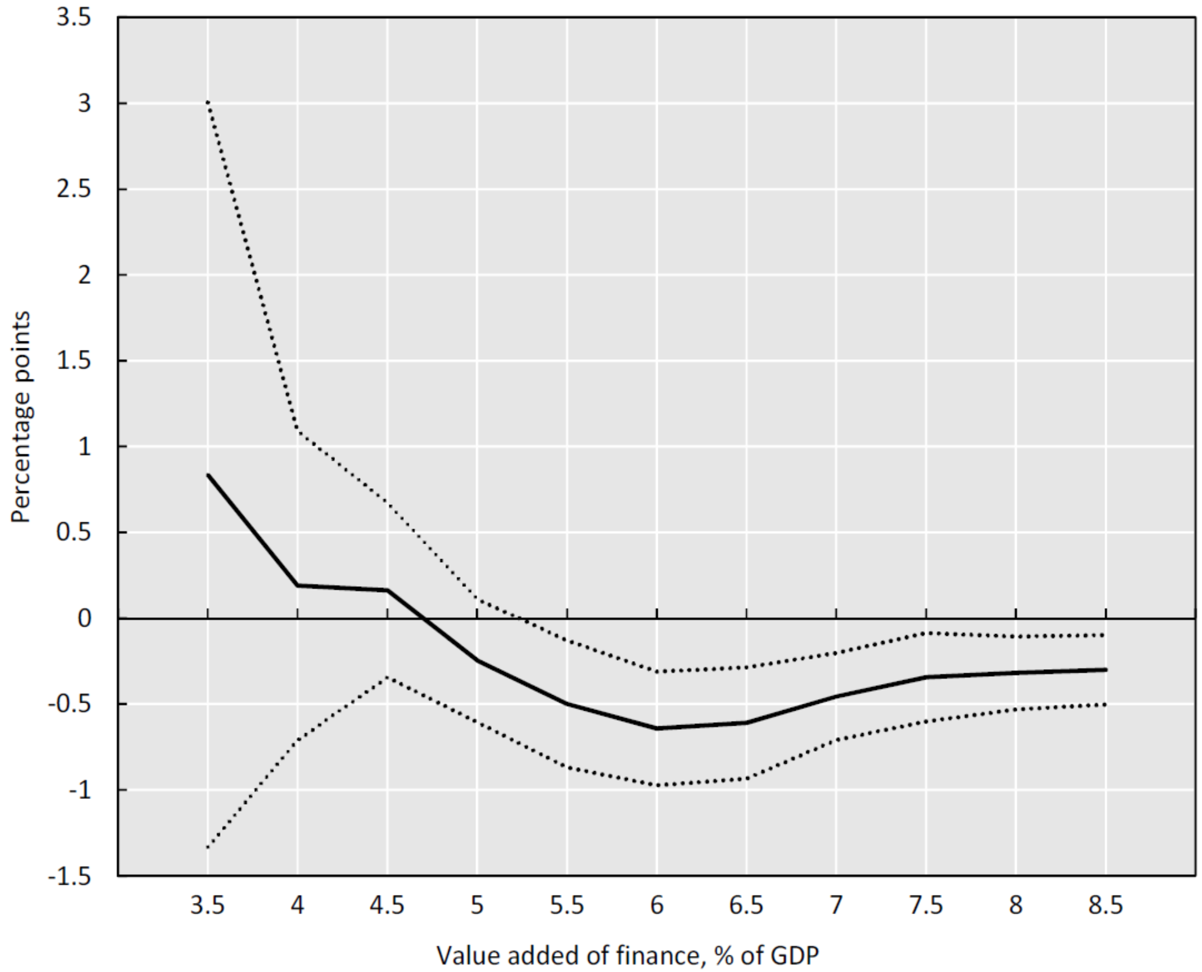


Source: IMF staff estimates.

Sahay et alia, (2015), 'Rethinking financial deepening: stability and growth in emerging markets', IMF Staff Discussion Note 1508

What have been the effects of financialisation?

A. Estimated change in per capita GDP growth when financial sector value added expands by 1% of GDP



'Finance and inclusive growth', OECD Economic Policy Paper no. 14

- Our interpretation is that because the financial sector competes with the rest of the economy for scarce resources, financial booms are not, in general, growth enhancing. This evidence, together with recent *experience* during the financial crisis, leads us to conclude that there is a pressing need to reassess the relationship of finance and real growth in modern economic systems. More finance is definitely not always better' (Cecchetti and Kharroubi, 2012, p.14).

De-financialisation

- The essential argument here is that the growth of the financial sector has not brought any faster growth, it has been associated with rising inequality and with increased incidence of financial crisis.
- The key roles of the financial sector should be the provision of a payments system and the socially efficient allocation of funds. It is the growth of the financial sector away from these key roles which lie behind many financial crises.

De-financialisation

- If the financial sector has become ‘too large’, should the direction of travel be towards de-financialisation? That is towards reducing the size and scope of the financial sector, and its re-structuring
- What should the roles of the financial sector be?

- Changing the scale of the financial sector: what role for taxation?
- Changing the structure of the financial sector: towards a more diverse banking sector

Taxes

- The role of financial transactions taxes; financial activity taxes etc.
- The clear purpose of such taxes should be the reduction in the volume of transactions, and the release of resources which are engaged in those transactions.

Developing financial institutions

- Alternative models of banking – the benefits of diversity
- Mutual, regional organisations
- Micro-credit and micro-finance

- State development banks including ‘green’ investment banks as a means of focusing investment funds onto ‘green’ and sustainable investments

Guided lending

- Guided lending: setting targets for the direction of lending by banks cf. US Community Reinvestment Act
- The need to co-ordinate the flow of funds with a sustainable industrial development programme.